



MEMORANDUM

To: City Council
Kim Payne, City Manager

From: Michael W. Hill, Director of Financial Services

Date: August 21, 2003

Subject: Financial Trend Monitoring System (FTMS)

The ability to evaluate the financial condition of the City is critically important.. While the City has historically prepared multi-year financial forecasts for the General Fund, accessing other methods that will enhance these forecasts continue to be evaluated. A tool that has been utilized by many local governments is the Financial Trend Monitoring System (FTMS) developed by the International City/County Management Association (ICMA). One important advantage of this system is that the analytical techniques it includes follow many of the same approaches used by the municipal credit rating industry. These techniques can help the City analyze and interpret its' financial condition. Trend analysis is critical in understanding and evaluating the City's financial condition. It also allows for a better understanding where the City has been, but more important, it provides a basis for more effective long-range planning. Such analysis can provide early warning signals of potential or emerging financial problems.

In past years, this information has been presented to you with only a snapshot of the past five years. Beginning this year, a ten-year history as well as a five-year projection is provided for your information.

As you review the attached information, please keep in mind the following:

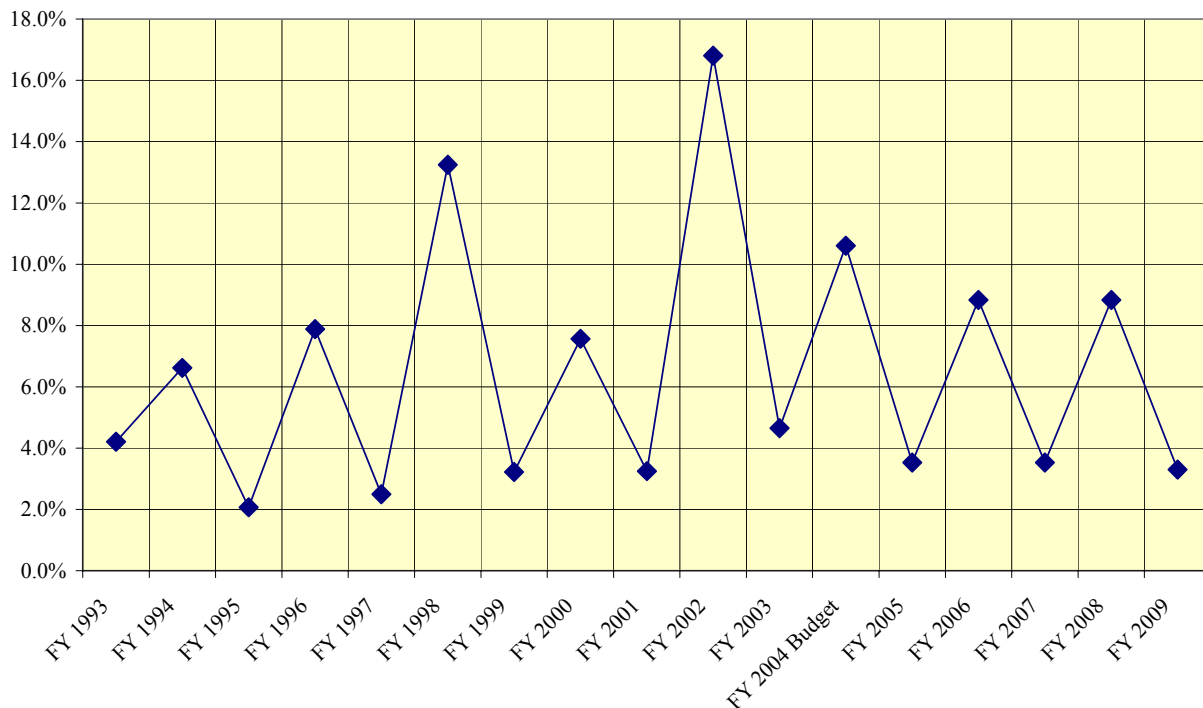
- **Warning Trend**
With each chart/indicator there is a warning trend which serves as a benchmark to evaluate the City's past performance/trend.
- **Consumer Price Index**
Where appropriate, trend data has been adjusted for changes in the Consumer Price Index to reflect past performance in constant dollars.
- **Future Revenue**
Based on past trends and the current economic conditions, revenues have been increased an average of two percent.
- **Future Operating Expenditures**
Expenditures have been increased at three percent per year for the period July 1, 2004 through June 30, 2009.
- **Future Debt Service**
Future debt service is based on the FY 2003-2009 Council-adopted Capital Improvements Program.

The purpose of presenting this information is to provide a framework for improving the City's overall financial management and decision-making processes. Whether the issue is how to balance future budgets, implement long-range plans, develop other underlying financial strategies, i.e. a compensation philosophy, this information should provide a framework for discussion. The attached financial trend information will be presented at the August 26, 2003 City Council work retreat.

Thank you.

Attachment

Percentage Change in Assessed Valuation



Warning Trend:

Declining or stagnant Real Property Tax Values (constant dollars)

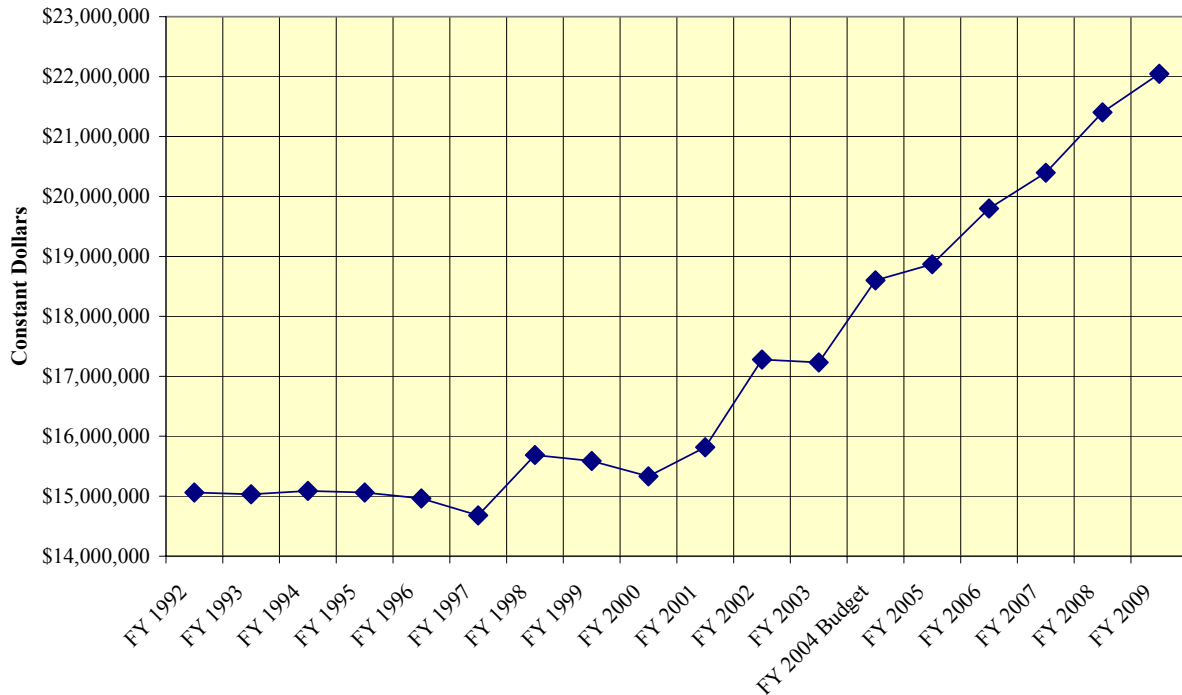
Description:

Real Property is taxed at \$1.11 per \$100 of assessed valuation

Analysis:

Real Property is reassessed bi-annually which is reflected in the increase in alternate fiscal years on the chart. The large increase in FY 1998 was the result of a bi-annual reassessment year that also included the first full real property assessment for the Frito-Lay manufacturing facility. In FY 2002, another large increase was realized from: (a) bi-annual reassessment, (b) first full real property assessment for a large portion of new retail development along the Wards Road corridor, and (c) the first year proration of property assessments for completed construction. Prior to FY 2002, completed construction was not recognized until the next year's assessment which could result in a loss of tax revenue of up to one year depending upon when construction was completed. The average percentage increase from FY 1993 to FY 2003 was 1.75%. For FY 2004, an increase of 6.4% is included. In the ensuing years for reassessment years a 5% increase is assumed with a 2% increase for non-reassessment years.

Real Property Tax Revenues



Warning Trend:

Declining or stagnant real property tax revenues

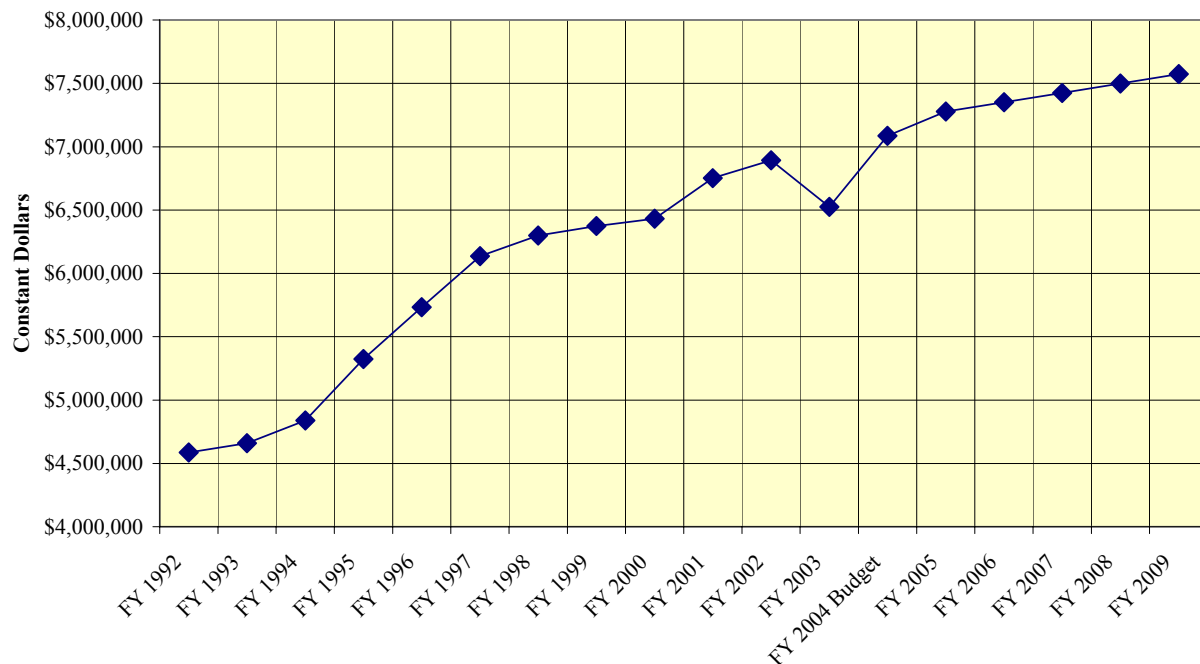
Description:

Real property is taxed at \$1.11 per \$100 of assessed valuation.

Analysis:

For the period FY 1992 through FY 1997 Real Property Tax revenues were constant with a slight decline in FY 1997. During this period the Real Property Tax rate was reduced from \$1.18/\$100 to \$1.16 in FY 1996, and from \$1.16 to \$1.13 in FY 1997. Further, although revenue increased in FY 1998, the Real Property Tax rate was reduced from \$1.13 to the current rate of \$1.11. In FY 2002, the increased revenue was attributable to: (a) bi-annual reassessment, (b) the first full year of real property assessment for a large portion of new retail development along the Wards Road corridor, and (c) the first year proration of property assessments for completed construction. The average annual increase since FY 1992 has been .77%. No change in the Real Property Tax rates is assumed for future years.

Personal & Business Property Tax Revenue



Warning Trend:

Decrease in yearly levy or notification of business closings

Description:

The current personal property tax rate is \$3.30 per \$100 of assessed valuation

Personal Property is assessed at 100% of trade-in value

Business Personal Property is assessed as follows:

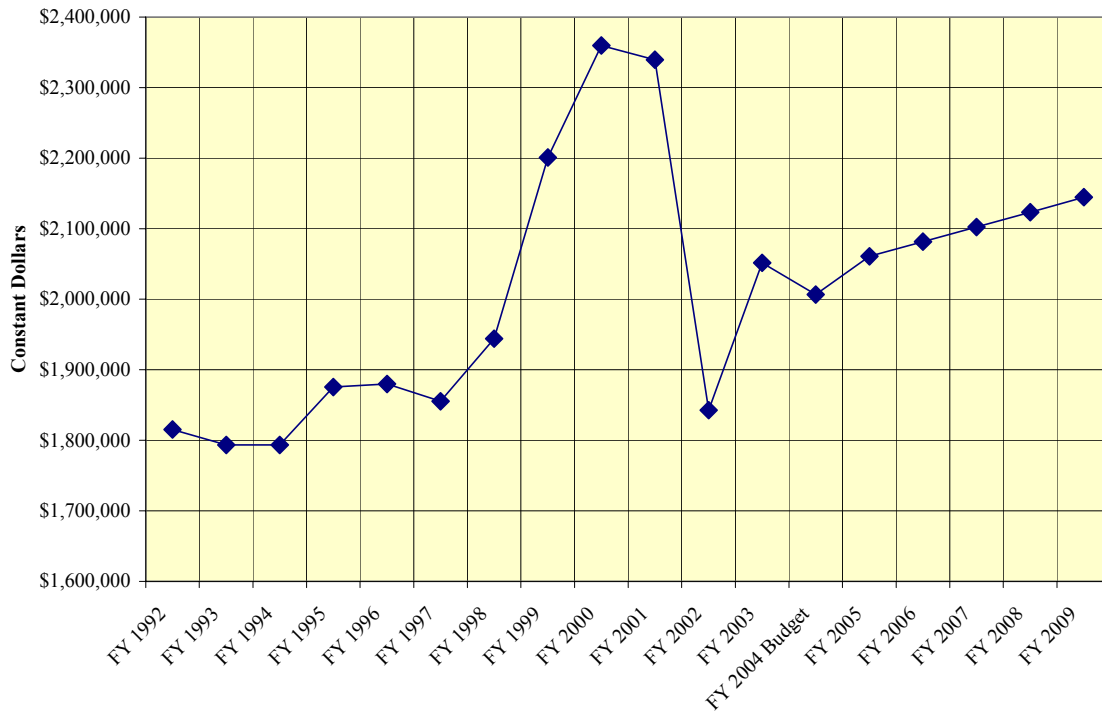
Equipment, 1-5 years of age is assessed at 30% of cost.

Equipment greater than 5 years of age is assessed at 25.35% of cost.

Analysis:

Average annual growth for Personal and Business Property Tax revenue since FY 1992 has been 2.25%. This revenue includes receipts from the Commonwealth of Virginia's Personal Property Tax Relief Act which began in FY 2000. Because of the downturn in the economy, and unemployment from recent layoffs, growth has been assumed at 1% per year for future years.

Machinery & Tools Tax Revenue



Warning Trend:

Declining or stagnant Machinery and Tool Tax Revenues

Description:

The current tax rate is \$3.00 per \$100 of assessed valuation.

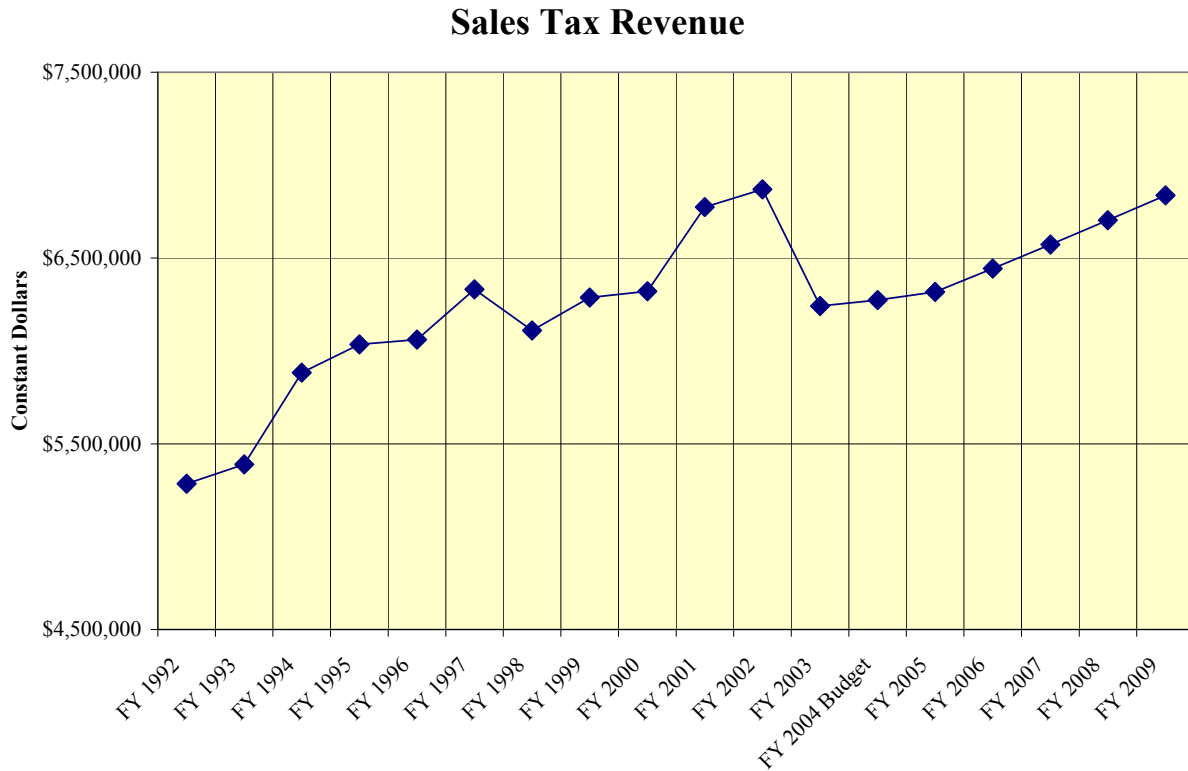
There is no cap imposed by the State Code.

Equipment, 1-5 years of age is assessed at 30% of cost.

Equipment greater than 5 years of age is assessed at 25.35% of cost.

Analysis:

The increase in Machinery and Tools Tax revenue beginning in FY 1998 was a result of an expanding economy in the late 1990's. During this period there were several manufacturing expansions that resulted in increased revenue. However, in FY 2002, as the economy weakened, the City experienced a major revenue loss of the same Machinery and Tool Tax revenue that increased from FY 1998 through FY 2001 from Ericsson. In addition to the revenue loss from Ericsson, Rock-Tenn changed its production process that resulted in eliminating two production lines and related equipment. These two events resulted in a loss of over \$700,000 in revenue. A portion of the Rock-Tenn revenue loss was recovered in FY 2003 with installation of new manufacturing equipment. The average annual percentage increase from FY 1992 to FY 2003 is 1%. Future growth is assumed at 1% per year.



Warning Trend:

Declining or stagnant Sales Tax Revenues

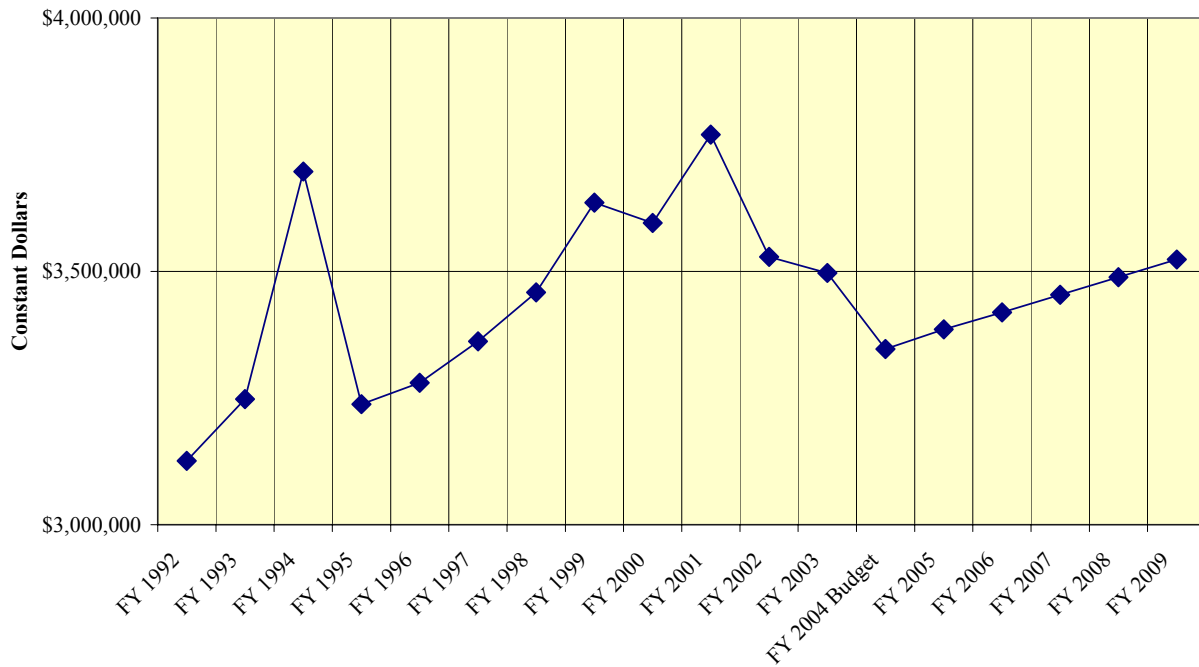
Description:

Sales Tax revenue to the City is 1% of the 4.5% total sales tax charged at the time of sale.

Analysis:

Sales Tax has experienced moderate growth from FY 1992 to FY 2003 with average annual increases of 1.16% during this period. As a result of the new business development along Wards Road, a sharp revenue increase was realized during FY 2000 and FY 2001. The small increase in FY 2002 from FY 2001 is due to a one-time adjustment overlooked by the external auditors. Discounting this adjustment, the increase from FY 2001 to FY 2002 reflected virtually no growth. The decline from FY 2002 to FY 2003 was attributable to the economic downturn during the past few years. FY 2004 estimates are level when compared to the receipts for FY 2003. For the period FY 2005 through FY 2009 a 1% growth rate has been assumed.

Business License Tax Revenue



Warning Trend:

Declining or stagnant Business License Tax Revenues

Description:

Business Licenses are assessed on the gross receipts of the business at the maximum rate allowed by the State Code:

\$.0020 per \$100 retail

\$.0028 per \$100 wholesale

\$.0016 per \$100 contractor

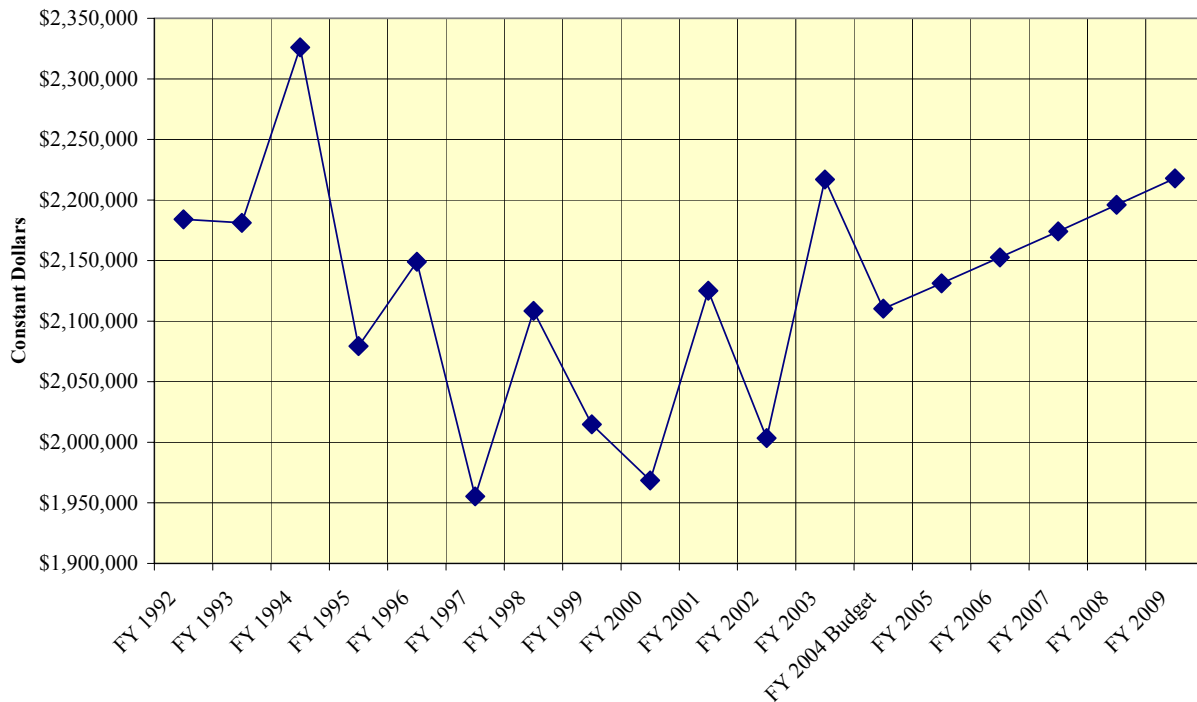
\$.0036 per \$100 business service

\$.0058 per \$100 professional service

Analysis:

Consistent with the economy, revenue from the Business License Tax experienced steady growth until the economic downturn began in the past few years. The increase in FY 2001 was primarily attributable to the retail development along the Wards Road corridor. The average annual increase since FY 1992 is .87%. Because of the sluggish economy, future growth is estimated at 1%.

Electric Utility Tax Revenue



Warning Trend:

Declining or stagnant Electric Tax Revenues

Description:

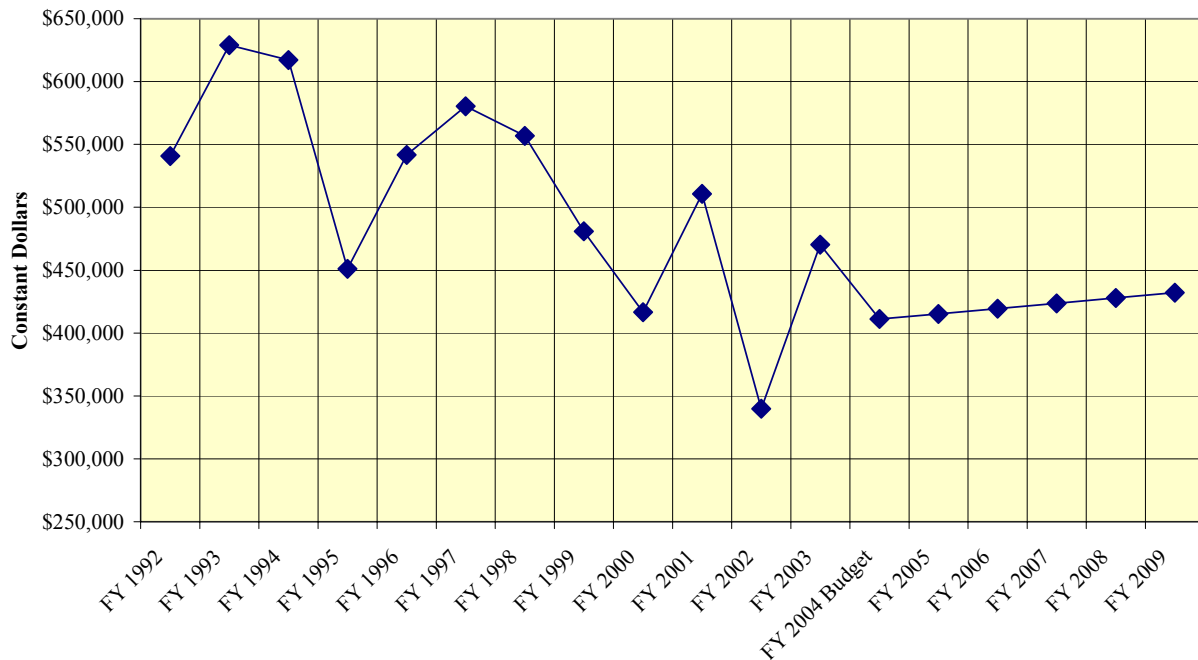
The residential consumer utility tax is effectively 7% of the amount of kwh consumed with no cap.

Commercial and industrial taxes are effectively 6% of the amount of kwh consumed with no cap on commercial but an annual cap of \$120,000 on industrial customers.

Analysis:

Although revenue from the Consumer Utility Tax on electricity can be affected by commercial and industrial activity, changes in weather patterns and the implementation of temporary rate increases which are later either repealed or reduced by the State Corporation Commission (SCC) create the most volatility in this revenue source. For example, winter weather during FY 2002 was warm compared to the cold and snowy weather experienced during FY 2003. Also American Electric Power (AEP) has the authority to implement rate increases while the proposal is being reviewed by the SCC which is a lengthy process. Should the full rate increase not be approved, then refunds are made to customers through their bills, which creates a reduction in revenue typically in the next fiscal year. Revenue from this source averaged a .18% annual increase from FY 1992 to FY 2003. Because of the sharp weather variation between FY 2002 and FY 2003, FY 2004 estimates represent an average increase between the two years. Revenue for the period FY 2005 through FY 2009 has been increased at a rate of 1%.

Gas Utility Tax Revenue



Warning Trend:

Declining or stagnant Gas Tax Revenues

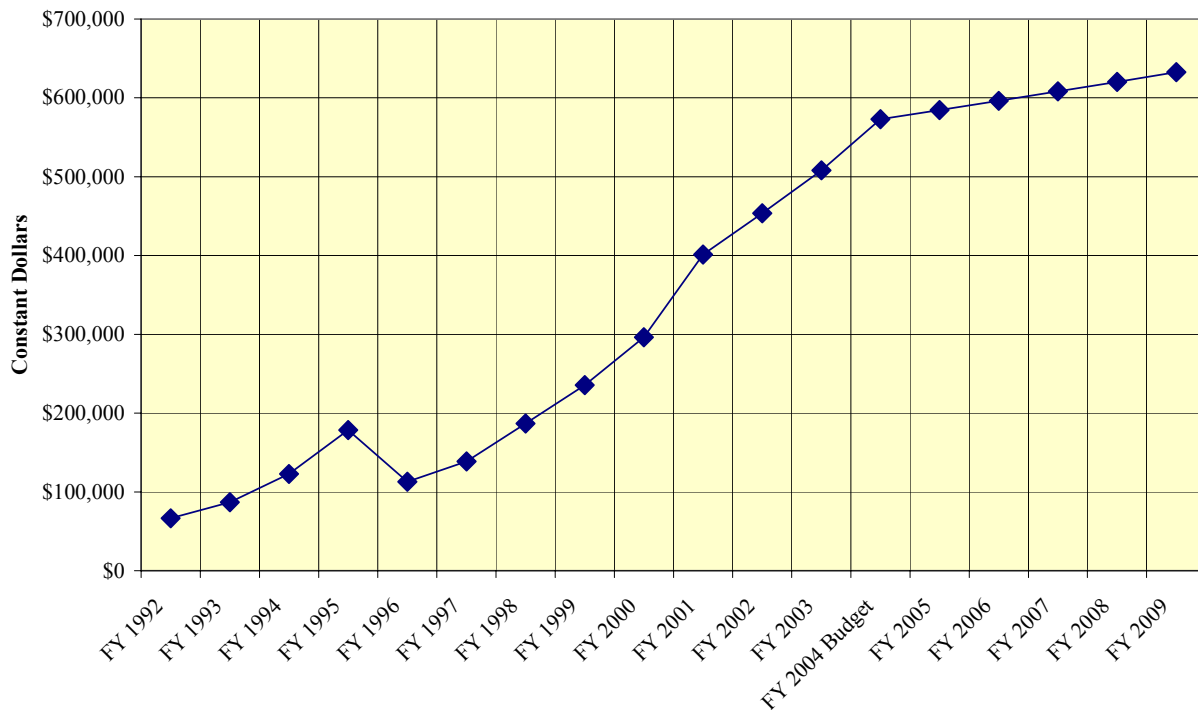
Description:

The residential consumer utility tax is 7% of the amount of cch consumed with no cap. Commercial and industrial taxes are effectively 6% of the amount of cch consumed with no cap.

Analysis:

Although revenue from the Consumer Utility Tax on natural gas can be affected by commercial and industrial activity, changes in weather patterns create the most volatility in this revenue source. For example, winter weather during FY 2002 was warm compared to the cold and snowy winter weather experienced during FY 2003. Revenue from this source averaged a .62% annual increase from FY 1992 to FY 2003. Because of the sharp weather variation between FY 2002 and FY 2003, FY 2004 estimates represent an average between the two years. Revenue for the period FY 2005 through FY 2009 has been increased at a rate of 1% per year.

Cellular Telephone Utility Tax Revenue



Warning Trend:

Declining or stagnant Cellular Tax Revenues

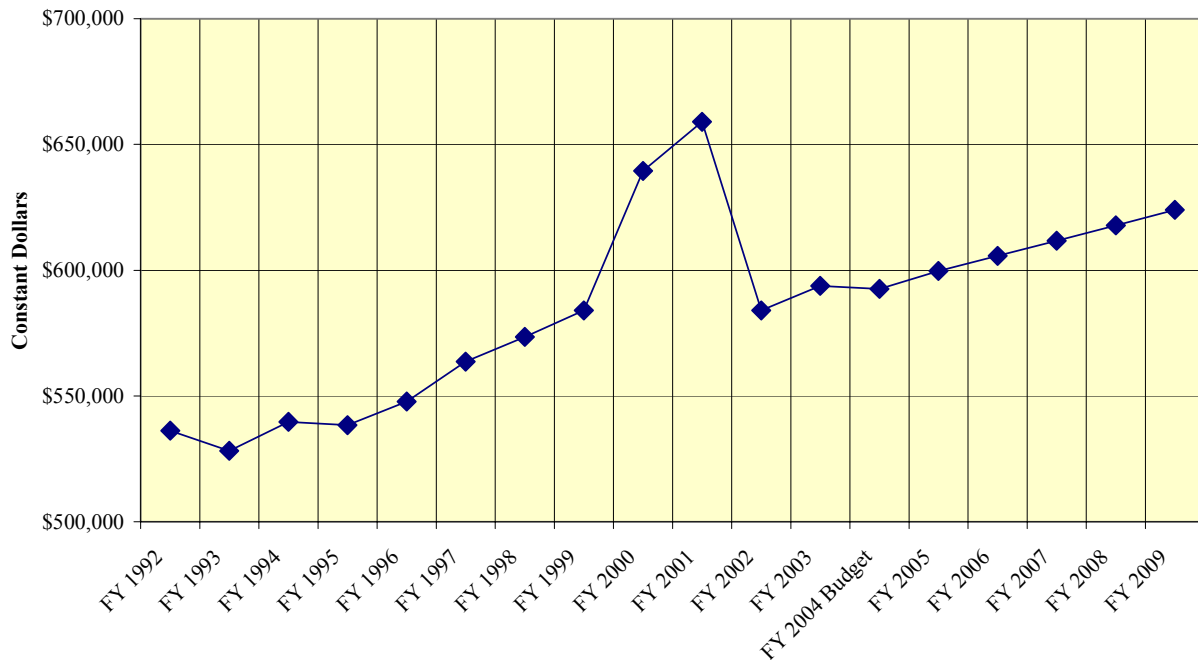
Description:

Cellular telephones are assessed a utility tax at a rate of 10% of the first \$30.00 with a maximum charge of \$3.00. This is the maximum allowed by the State Code.

Analysis:

Cellular Telephone Utility Tax revenue has increased sharply over the past eight years experiencing an average growth rate of 14% from FY 1992 to FY 2003. With recent news reports that many users are moving from a combination of land lines and cellular phones to strictly 'cellular' combined with the potential that the market could become saturated, revenue for the period FY 2005 through FY 2009 has been increased at a rate of 2%.

Telephone Utility Tax Revenue



Warning Trend:

Declining or stagnant Telephone Tax Revenues

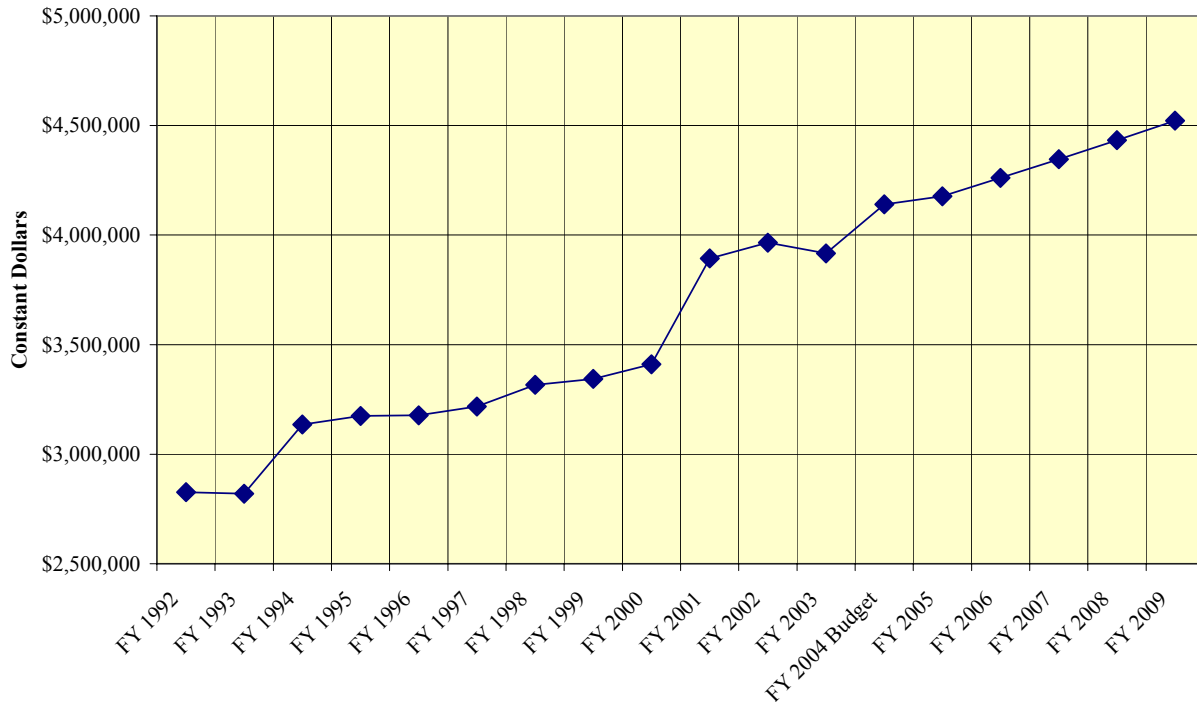
Description:

Telephone Utility Tax rate is 7% with no cap (does not include long distance charges).

Analysis:

The revenue pattern from the Telephone Utility Tax has been relatively flat showing only a small increase in constant dollars from FY 1992 to FY 2003. The average annual increase since FY 1992 is .96%. The decrease shown in the most recent years could be attributable to the increased use of cellular telephones and the consumer going strictly 'cellular'.

Meals Tax Revenue



Warning Trend:

Declining or stagnant Meals Tax Revenues

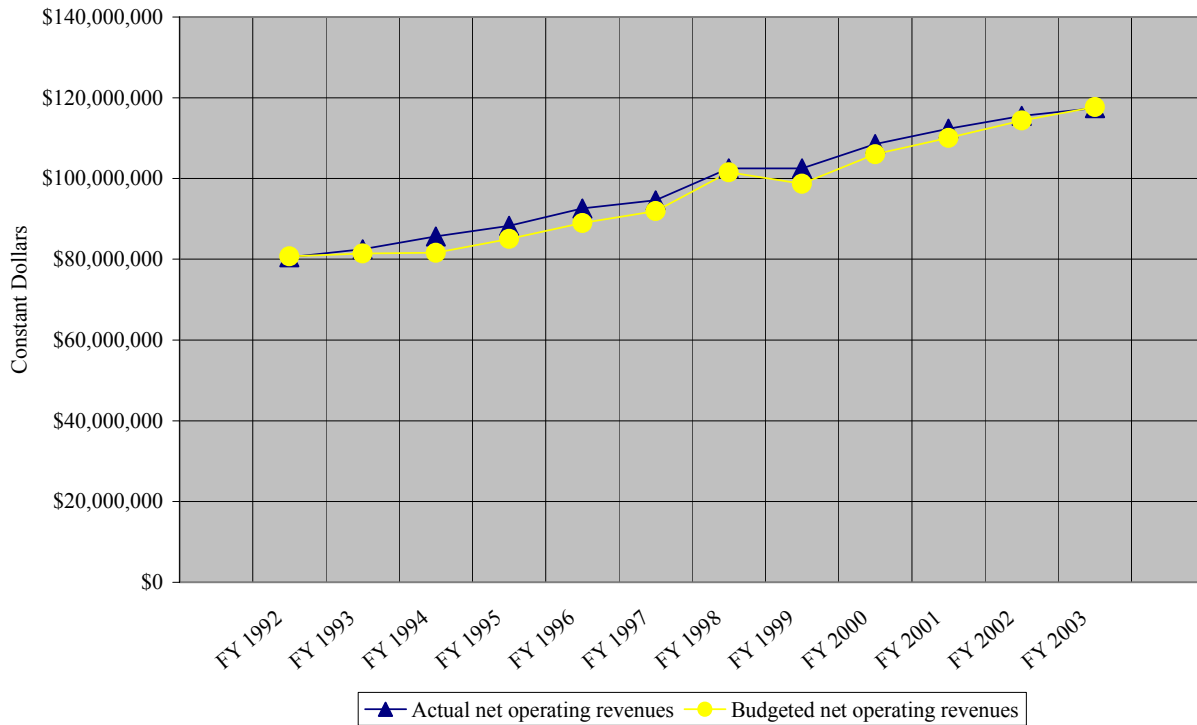
Description:

Meals tax is 6% of the cost of the meal. There is no cap imposed by the State Code.

Analysis:

The average annual growth in Meals Tax from FY 1992 to FY 2003 was 2%. In FY 2001, the sharp increase in revenue was attributable to a .5% increase in the Meals Tax rate from 5.5% to 6%. During FY 2002, restaurant development continued along the Wards Road corridor sustaining growth in this revenue source. The FY 2004 revenue projection was increased to reflect new restaurants along the Wards Road corridor as well as annualizing the additional revenue for future revenue projections from these new restaurants. For the period FY 2005 through FY 2009, a 2% growth rate is assumed.

Revenue Shortfall or Surplus



Warning Trend:

Increase in revenue shortfalls as a percentage of actual net operating revenues

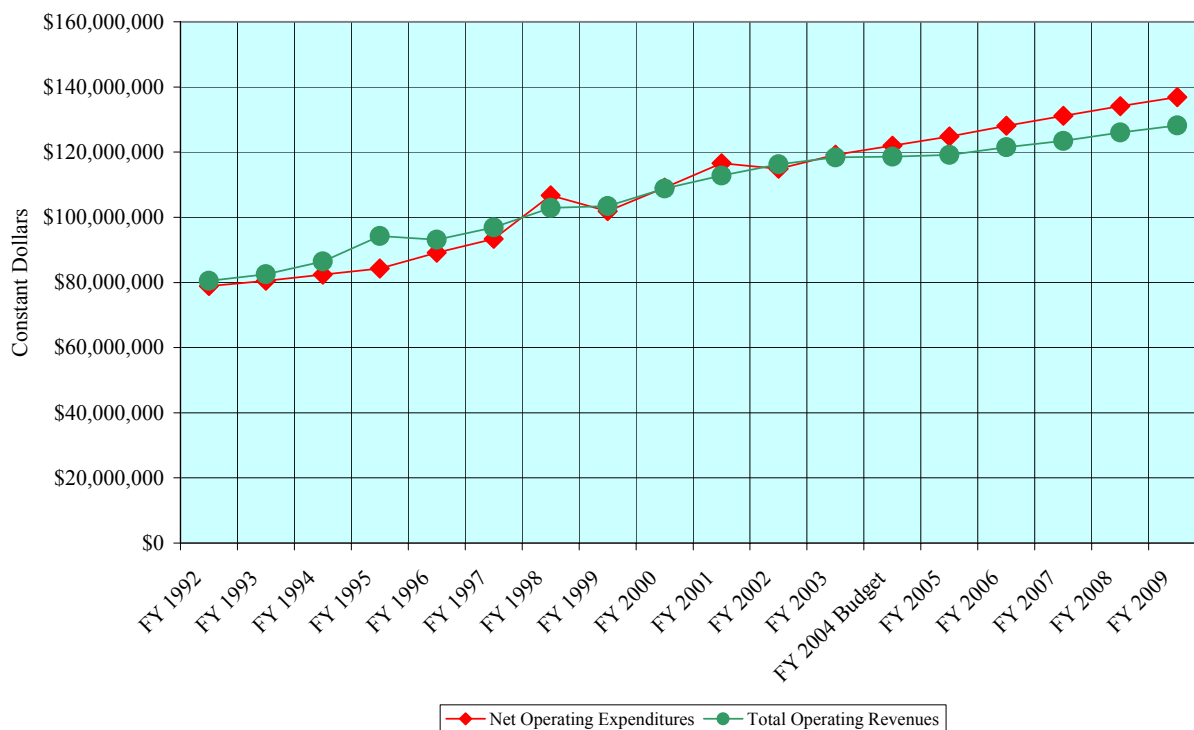
Description:

Actual net revenues are compared to budgeted revenues.

Analysis:

For the period FY 1992 through FY 2002 the performance of actual revenues has been greater than the budget. This is a positive trend with increased revenues accruing to the General Fund, however, since FY 1999, the variation has been declining to a point for FY 2003, subject to final closeout and audit, there was a slight shortfall. This decline reflects the impact of the downturn in the economy as well as preparing closer budget estimates reducing the margin for changes in the many factors that can affect revenue performance. The fluctuations in part are attributed to unanticipated revenues such as (a) FEMA funding for the 1993 ice storm received in FY 1994, (b) State funding for the 1993 wind storm received in FY 1994, (c) funding from the Governor's Fund for Frito-Lay in 1998 and Ericsson 1999. Even without the one-time monies, revenue surpluses were realized. However, as the downturn in the economy has progressed, the gap between budgeted revenues and actual revenues has narrowed.

Operating Revenues and Expenditures



Warning Trend:

General Fund operating expenses increasing faster than revenue growth

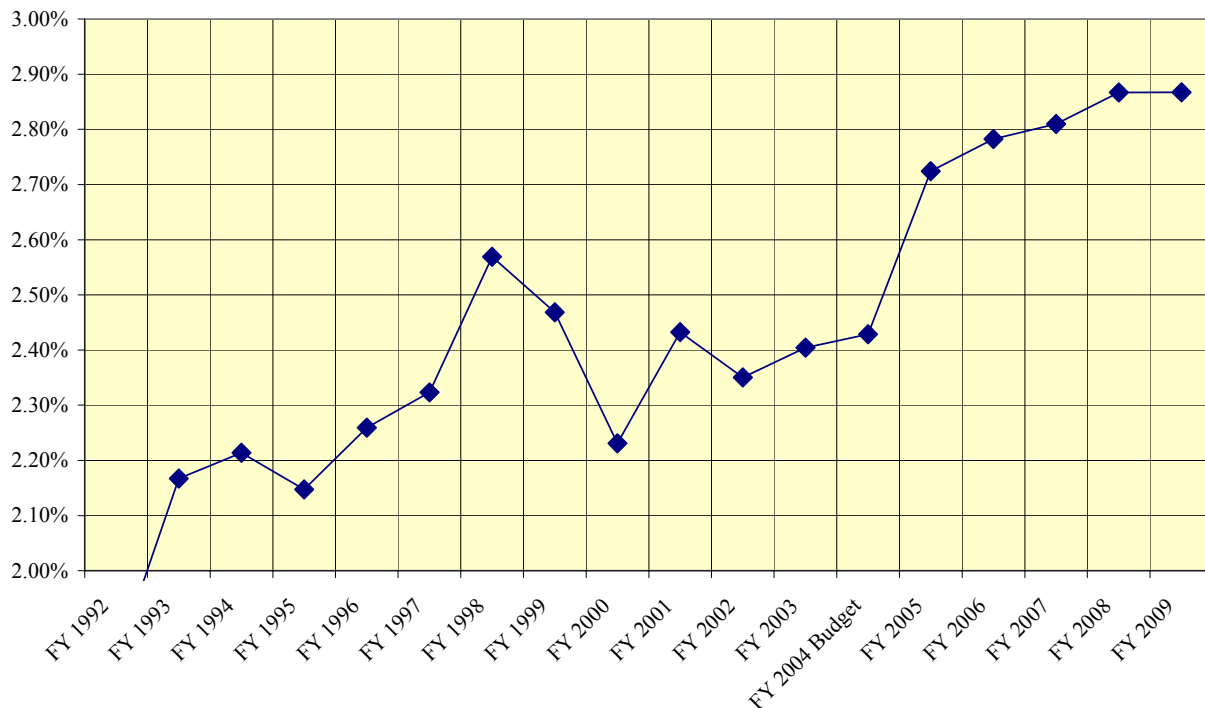
Description:

General Fund expenditures including debt service

Analysis:

The budget is prepared each year focusing on the continued delivery of efficient and effective government services to the City's citizens, businesses and visitors. The budget incorporates the ideas of the elected Officials, City staff and the community. Throughout the years the increases have been relatively consistent with the percent increase of the Consumer Price Index (CPI). The CPI, which is a best measure of inflation, measures the average change in prices overtime of goods and services purchased by households. The General Fund operating budget has increased each year relative to this index except for FY 1997 and FY1998. The increases in these years can mainly be contributed to the creation of the Airport Fund, in which the City began to budget transfer funds for the operation of this enterprise. Future expenditures are projected to increase 3% annually.

Long Term Debt as a Percentage of Assessed Valuations



Warning Trend:

Increasing long-term debt as a percentage of assessed valuation

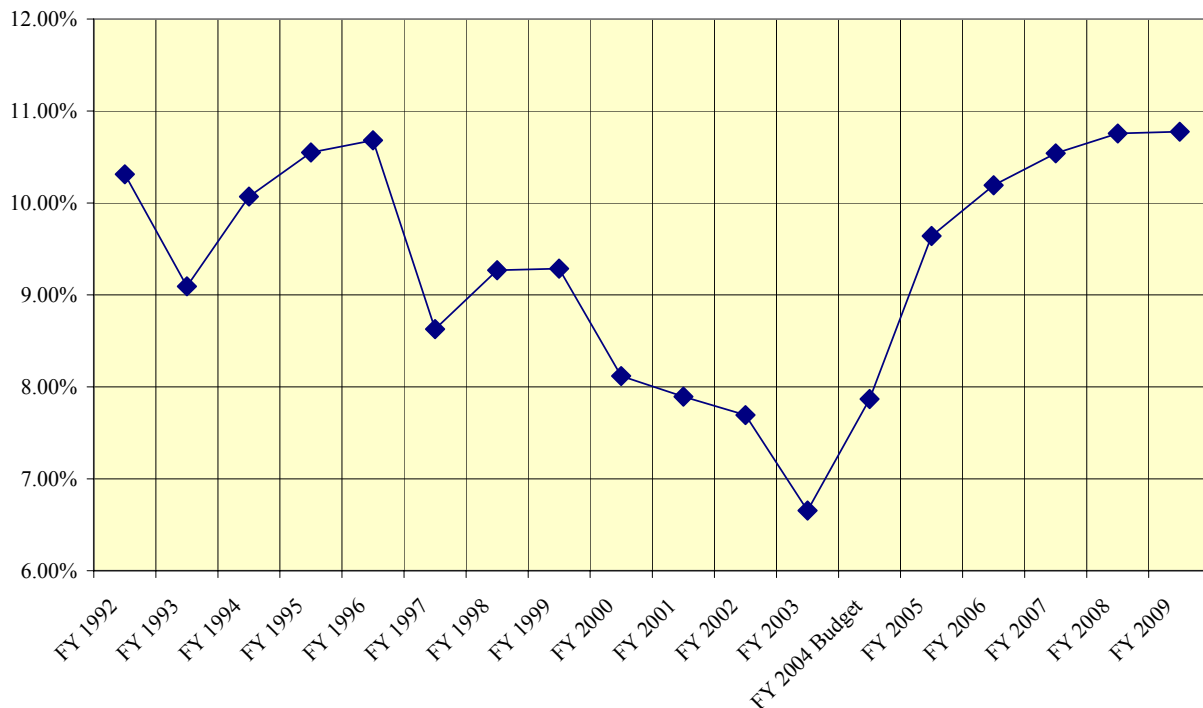
Description:

The Council-adopted financial policy provides that tax-supported debt will not exceed 5% of the assessed valuation of taxable property. The State Code provides a limit of 10% of taxable property.

Analysis:

For the period FY 1992 through FY 2003, long-term debt has been below 2.6%. This is well within the financial policy limits and is viewed very favorably by the bond rating agencies. With the increased borrowing for school construction, it is projected that it may increase to almost 2.9%. The large increase from FY 2004 to FY 2005 is the result of scheduling the FY 2004 bond issue resulting in a lag of when it will be reflected in the City's outstanding indebtedness.

City and School Debt Service



Warning Trend:

Increasing debt service as a percentage of expenditures

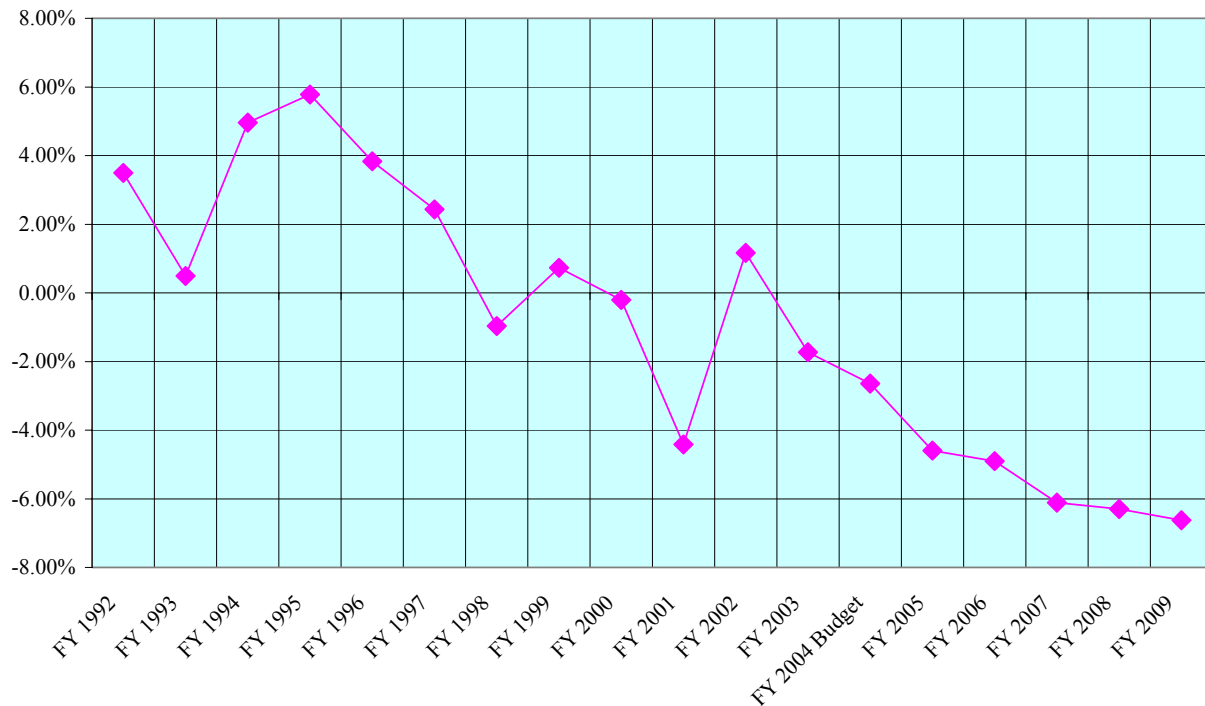
Description:

The Council-adopted financial policy provides that annual debt service for tax-supported debt should not exceed 10% of total General Fund Expenditures plus (a) transfers to the School Operating Fund and (b) Reserve Allocations.

Analysis:

The City adopted several financial policies in FY 2000 that have provided guidance in the management of municipal finances on of which was in the area of debt management. From FY 1992 through FY 1996, the City exceeded what is now the 10% limit except for FY 1993. Through the guidance of the debt policy for the past several years, annual debt service has been below the 10% limit. With the increased borrowing for schools, particularly E. C. Glass, the City may temporarily exceed the 10% threshold. This has been discussed with the bond rating agencies and they view the renovation of E. C. Glass as a one-time event as it is not likely that a new high school will be constructed in Lynchburg. The large increase from FY 2004 to FY 2005 is the result of scheduling the FY 2004 bond issue resulting in a lag of when it is reflected in the annual budget. The estimated future debt service is based on the FY 2004-2009 Capital Improvements Program.

Operating Deficit or Surplus



Warning Trend:

Decrease in general fund operating surplus as a percentage of net operating revenues

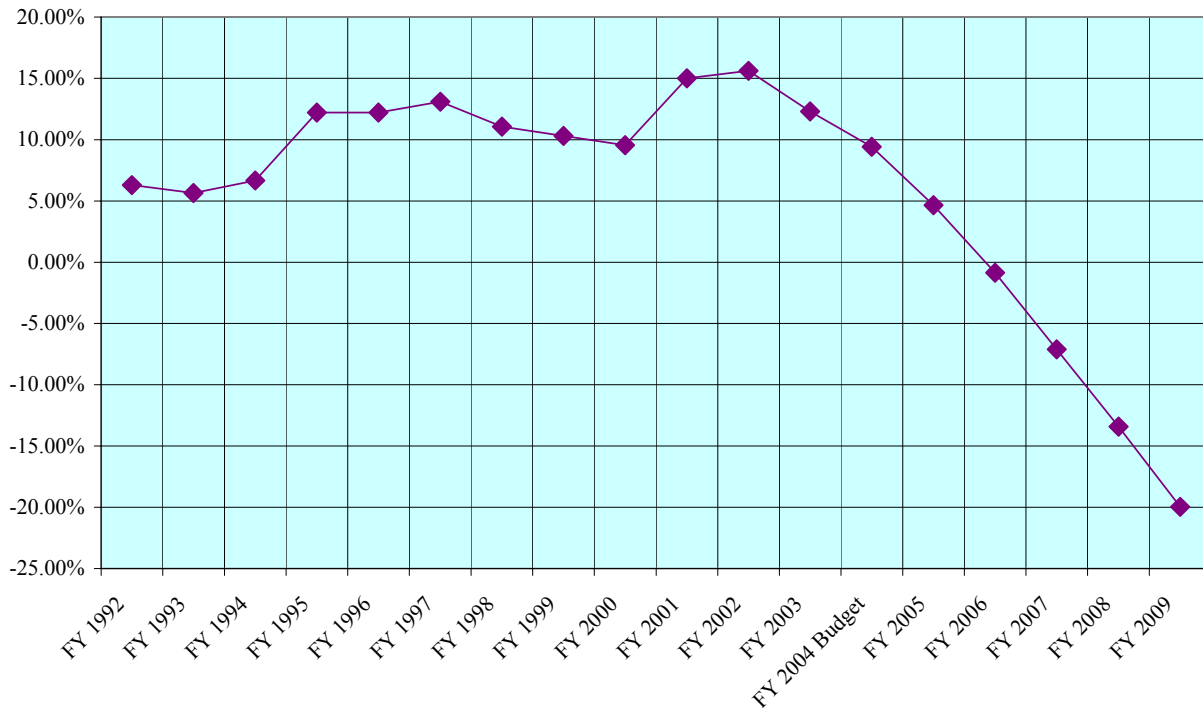
Description:

General fund operating deficit or surplus divided by net operating revenues

Analysis:

Since FY 1995, the surplus of revenues over expenditures has declined, with exception of FY 2001, to a point of becoming a deficit beginning in FY 2003. A deficit does not always mean that the budget is out of balance because fund balance from prior years may have been used. Due to the transfer of \$4.9 million to both the City Capital and School Capital funds for one-time funding of projects, FY 2001 experienced a sharp deficit. Without this transfer, the City would not have experienced a deficit. This indicator is especially important because a pattern of operating deficits can be one of the first signs of imbalance between the revenue structure and expenditures. Two or more years, and in particular within a five-year period, operating deficits would probably result in more attention by bond rating agencies. Planned drawdowns would not indicate a serious problem. However, aside from planned drawdowns, it would result in more critical credit analysis. Based on current budget projections, the future operating deficits represent serious financial implications.

Cumulative Fund Balance



Warning Trend:

Declining undesignated fund balance as a percentage of revenues

Description:

The Council-adopted financial policies provide that the City will maintain a minimum Undesignated General Fund Balance equal to 7% of General Fund revenues, with a targeted goal equal to 10% of General Fund revenues. In the event the Undesignated General Fund Balance is used to provide for temporary funding of unforeseen emergency needs, the City shall restore the Undesignated General Fund Balance to the minimum of 7% within 2 fiscal years. If the Undesignated General Fund Balance falls below the target of 10%, the City shall restore the Undesignated General Fund Balance to the 10% target within five fiscal years.

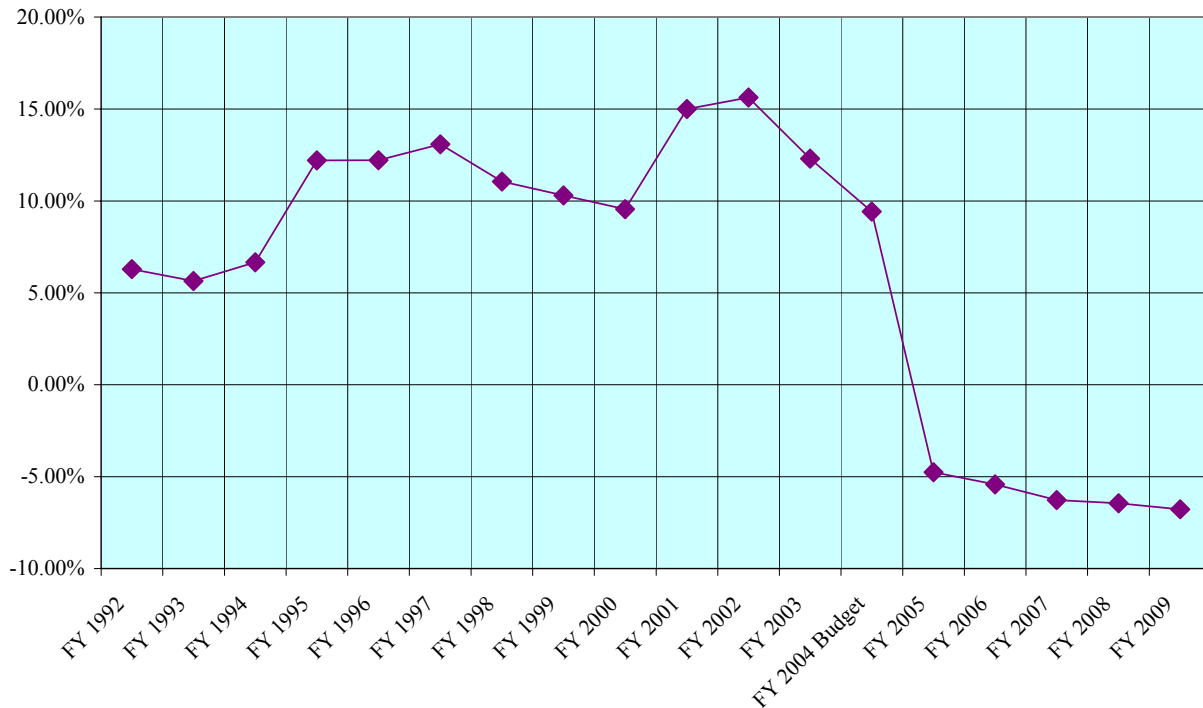
Analysis:

Even before the formal fund balance policy adoption in FY 2000, the City was above the policy threshold of 10%. However, based on current projections, beginning in FY 2006, the General Fund is projected to be in a deficit position and will continue to decline.

With this emerging issue, the City will need to begin developing strategies to maintain the fund balance in accordance with the Council-adopted policy.

Revised

Fund Balance



Warning Trend:

Declining undesignated fund balance as a percentage of revenues

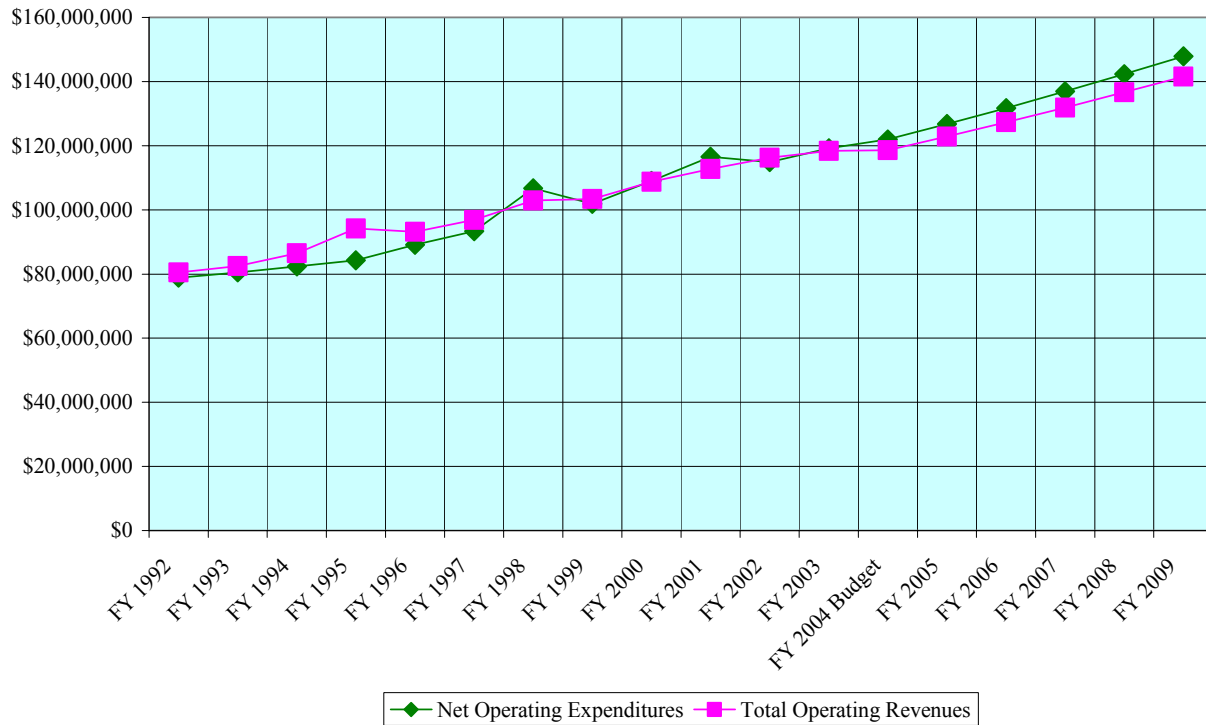
Description:

The Council-adopted financial policies provide that the City will maintain a minimum Undesignated General Fund Balance equal to 7% of General Fund revenues, with a targeted goal equal to 10% of General Fund revenues. In the event the Undesignated General Fund Balance is used to provide for temporary funding of unforeseen emergency needs, the City shall restore the Undesignated General Fund Balance to the minimum of 7% within 2 fiscal years. If the Undesignated General Fund Balance falls below the target of 10%, the City shall restore the Undesignated General Fund Balance to the 10% target within 5 fiscal years.

Analysis:

This chart presents the amount of deficit for each year rather than a cumulative amount. It assumes each year the deficit is eliminated. However, it does not provide for the 10% required Fund Balance.

Operating Revenues and Expenditures (Prior Year Average)



Required Funding to Meet 10% Fund Balance Target

